HELP ?

Developing China's Hinterland: From autarky to anarchy?

Challenge; Armonk; Mar/Apr 1996; Weinstein, Bernard L;

Volume: 39
Issue: 2
Start Page: 55
ISSN: 05775132
Subject Terms: Rural development
Regions
Policy making
Industrial development
Economic reform
Economic policy
Economic planning
Social impact
Public policy
Political behavior
Policy making
Economic growth
Classification Codes: **9179**: *Asia & the Pacific*
1120: *Economic policy & planning*
1110: *Economic conditions & forecasts*
Geographic Names: Peoples Republic of China
China

Abstract:
Because of the growing disparities between the coastal provinces and other regions of China, policies to achieve faster growth rates in ***China's hinterlands*** *have been the topic of much debate in recent years. Two important policy implications can be drawn from the fragmented nature of the Chinese economic system: 1. Central or national macroeconomic policies will have differential effects on each region, province, and municipality. 2. Central economic policy is de facto regional development policy. The impulse to direct and reallocate China's internal resources and foreign investment toward lagging hinterland regions may prove ineffective. Because of the huge numbers of people living in* ***China's hinterlands****, totally uncontrolled migration could result in perpetual economic and political turmoil. China must pursue a strategy of encouraging industrial development in the hinterlands, even if some resource misallocation occurs. To minimize these costs, policy makers should strive to define economic areas based on transactional relationships and not political boundaries.*

Full Text:

[Headnote]
From the vantage point of Western eyes, we tend to see China's remarkable economic development as uniform across the vast country. But as Bernard Weinstein points out, much of China's hinterlands have been left behind. This economist thinks that distributing the benefits of rapid growth throughout China will prove difficult and will sorely try the current political structure.

For more than a decade, the Chinese economy has been in the throes of a dramatic transformation. From 1949 to the late 1970s, virtually all policies relating to the allocation of resources and the distribution of income were dictated by the central planners of the State Council in Beijing. Committed to a program of economic self sufficiency, China traded only with countries that shared its puritanical Marxist ardor-such as Cuba, North Korea, North Vietnam, and Albania. Then, under the tutelage of Premier Deng Xiaoping, the Communist party began a process of economic liberalization in 1978, which subsequently led to the ending of agricultural communes, the creation of "special economic zones," and an initial run at privatizing stateowned industries.

On the surface, China's transformation from a centrally directed to a "socialist market" economy appears to be a roaring success. According to the World Bank, China now boasts the third-largest economy on the globe. Since 1978, gross domestic product has increased tenfold, and real growth rates above 10 percent annually have been common in recent years. China has opened its economy to foreign trade and investment and currently exports more to the United States than any country other than Hong Kong. Indeed, since Deng's liberalization began, China's external trade has ballooned from $10 billion to nearly $300 billion, while foreign investment has jumped from virtually nothing to more than $30 billion in 1994.

But the Chinese "economic miracle" also has its dark side. Rapid growth has been accompanied by rapid inflation, with consumer prices rising 17 percent in 1993 and 27 percent in 1994. Nearly one-half of the state-owned enterprises (SOEs) are losing money, and plans to restructure and privatize these entities have stirred strong resistance from both the Communist party (whose cadres dominate the management of the SOEs) and workers (who fear the loss of secure employment plus the cheap housing and medical care provided by the state). Though the SOEs employ only 76 million workers out of China's labor force of 500 million, they consume 70 percent of state investment funds and contribute less than half the country's economic output.

While technically bankrupt, SOEs remain afloat on government subsidies. China's budget deficit continues to escalate, doubling between 1993 and 1994 to $15 billion-or nearly 25 percent of total government receipts. Seemingly unable (or unwilling) to reform the country's outdated monetary and fiscal systems, the central government sits on the sidelines while the inflationary fires continue to burn and increasingly autonomous provincial and municipal governments invest scarce capital in speculative real estate or foreign ventures.

Though real GDP per capita has increased, income distribution has worsened in recent years because of the bifurcated nature of Chinese development. Virtually all of the economic action has taken place in the special economic zones of Zhuhai, Shenzhen, Shantou, and Xiamen or in other east coast cities such as Shanghai, Beijing, and Tianjin, while the hinterlands have experienced little of the new-found prosperity. With urban workers earning three times the income of their rural cousins, peasants by the hundreds of thousands have been flocking to Beijing and the coastal cities in search of a better life. This, in turn, has overloaded the urban infrastructure and caused a tremendous amount of social unrest in China's eastern cities. The mass migration to the cities, which the authorities seem unable to control, has also had a devastating impact on the farm sector. Since 1993, grain production has been falling and China has become a net food importer.

Graft and corruption are rampant at all levels of government, from influence-peddling by Politburo members to bribe-taking and extortion by municipal employees. The absence of an impartial legal system and a tradition of property rights poses additional dangers for entrepreneurs and foreign investors. Early in 1995, the Communist party began an anticorruption campaign that has resulted in the purging of some 100 party officials and "state entrepreneurs." But the crackdown on graft may have more to do with postDeng political posturing than a commitment to improve China's perceived business climate.

In stark contrast to the United States and Russia, China's military budget continues to grow, nearly doubling between 1991 and 1995. But there is some leeway in this. The People's Liberation Army

(PLA) isn't actually increasing the size of China's armed forces or spending additional billions on military hardware. Instead, the PLA has evolved into a huge business conglomerate that owns hotels, shipping companies, pharmaceutical firms, karaoke bars, brothels, and many other enterprises. In fact, the PLA currently owns or controls more than 20,000 companies across China and earned profits of about $5 billion in 1994.

CHINA'S REGIONAL DISPARITIES

Because of growing economic disparities between the coastal provinces and other regions of China, policies to achieve faster growth rates in China's hinterlands have been the topic of much debate in recent years. In the process, a number of Western experts (including this writer) have been asked to render their opinions and recommendations as to the most appropriate strategies to help China realize its regional development goals. But the experience of other countries, especially in the West, may have limited application to the challenges of regional economic development in China.

These limitations stem partly from the fact that China and the West have different social, cultural, and political traditions and that China is growing at breakneck speed. What's more, China is going through an "industrial" and "post-industrial" revolution at the same time, which is to say that manufacturing and service industries are expanding in tandem. But the key difference between China and other nations, regardless of their stage of development, is that only China has 1.2 billion people. In short, the sheer size of China and the need to control population growth and population mobility limits the transferability of the Western experience to the Chinese setting.

A corollary to this important demographic fact is that at present there is no truly integrated political unit that can be called a "Chinese economy." China, like most large countries, is an agglomeration of regional economies, all growing at different rates with different problems and challenges. Thus, the national statistics for China are simply weighted averages of China's regional economies. The same is true for more advanced countries, such as the United States, where growth rates, incomes, and unemployment levels vary widely during good times and bad.

Two important policy implications can be drawn from the fragmented nature of the Chinese economic system. First, central or national macroeconomic policies will have differential effects on each region, province, and municipality. Second, central economic policy is de facto regional development policy.

THE URBAN-RURAL DICHOTOMY

As discussed above, though millions of farmers and peasants have flocked to China's large cities, especially those along the coastal plain, the vast majority of Chinese still live in rural areas. One of the key issues facing economic planners and policy makers in China is whether to bring jobs to people or people to jobs.

Historically, economic development and industrialization have been essentially urban phenomena, with rapid growth first occurring in large metropolitan areas and then fanning out to suburban and, eventually, exurban areas. This has certainly been the case in North America, Europe, and Japan. According to experts and pundits, a new paradigm called the "citystate" will dominate the global economy in the twentyfirst century, especially around the Pacific Rim. Singapore, Hong Kong, Tokyo, and Los Angeles are but a few examples of extended urbanized areas that are, and will continue to be, major manufacturing, trade, information, and financial centers.

Against this backdrop, the impulse to direct and reallocate China's internal resources and foreign investment toward lagging hinterland regions may prove ineffective. The experiences of the Western market economies as well as the former Soviet Union suggest that efforts to disperse industry in some sort of "geographically equitable" manner have usually failed. In any event, they've been quite expensive and have resulted in the serious misallocation of scarce human, technical, and capital resources.

Still, because of the huge numbers of people living in China's hinterlands, totally uncontrolled migration could result in perpetual economic and political turmoil. Beijing, Tianjin, Shanghai, Guangzhou, Hong Kong, and other large cities are physically incapable of accommodating another 500 million to 1 billion souls. Thus, China must pursue a strategy of encouraging industrial development in the hinterlands, even if some resource misallocation occurs. To minimize these costs, however, policy makers should strive to define economic areas based on transactional relationships and not political boundaries. A good example would be the Beijing-Tianjin corridor, a region of nearly 20 million people with complementary industries and infrastructure.

In a similar vein, policy makers must decide whether industrial policy and regional policy are the same or different. In the context of China, they are probably one and the same, since regional development should ideally be based on industrial advantages or opportunities.

IDENTIFYING DEVELOPMENTAL GOALS

Obviously, regional development programs should be framed with specific objectives or goals in mind. But frequently there is confusion or disagreement as to which are the preferred outcomes. Some of the following goals may be complementary, but others may be contradictory:

*job creation

* rising real per capita income

* income redistribution

* poverty reduction

* enhanced quality of life

* broadening the local economic base

* development of export-oriented industries

For example, an emphasis on poverty reduction as an economic development objective may fly in the face of policies designed to enhance efficiency, which should be the overarching goal of regional development programs. Regional development may reduce poverty and improve the distribution of income over time, but then again it may not. The American experience is instructive in this regard.

Though the United States has never embraced explicit regional development policies, with the possible exception of the Appalachian Regional Commission, over the past 60 years a significant degree of regional income convergence has occurred. In 1930, for example, southern incomes were 50 percent below the national norm, while northern incomes were 30 percent above. By 1990, the South was only

10 percent below the national per capita average while the Northeast was only 10 percent above. But over this same period the United States has had limited success in reducing the overall incidence of poverty. Indeed, at present America's official poverty rate-about 15 percent is more than double that of China. What's more, though interregional income differentials have narrowed, in some parts of the United States intraregional income disparities have actually widened.

POLICY OPTIONS TO ENCOURAGE REGIONAL ECONOMIC DEVELOPMENT

Describing the national and regional economic problems and challenges facing China today is a relatively easy task. But identifying and prioritizing possible solutions--or public policies is more difficult. This would also be true for any other nation struggling with regional development, but the sheer size of China and its component economic regions, not to mention the dissipation of political power from Beijing to the provinces and the PLA, makes the task even more daunting.

Nonetheless, nine broad policy options can be enumerated that have significant impact on regional economic performance:

1. Conventional Macroeconomic Policy

Macropolicy comprises monetary, fiscal, and regulatory interventions in the marketplace. Though China cannot tailor separate macropolicies for different regions, changes in the money supply, interest rates, the level of taxes and spending, and the regulation of prices will invariably have different regional impacts. Thus, macrolevel policy makers should be sensitive to the regional consequences of their decisions.

2. Intergovernmental Transfers, Grants, and Subsidies

To improve industrial efficiency and international competitiveness, as well as comply with the rules of the General Agreement on Tariffs and Trade (GATI, China must continue the process of reducing subsidies. The socialist market economy must be driven by pricing signals, and subsidies severely distort these signals. In terms of grants and other intergovernmental transfers, the experience of the West has not been positive because the grant-making process has become as politicized as the direct spending process. What's more, intergovernmental grants designed to equalize for differences in per capita incomes, fiscal capacity, or some other measure of "need" have been dismal failures in North America and Europe. So China should proceed with caution in implementing its new revenue-sharing program between the central government and provincial/municipal governments.

3. Industrial Targeting and Development Incentives

Industrial targeting is a reasonable strategy for identifying the best prospects for a particular region or location. The analysis of optimal industries, however, must be based on a candid and realistic assessment of a given location's strengths and weaknesses. To the extent possible, the process should be kept out of the political domain. As regards development incentives such as low-interest loans, tax abatement, and the like-they should be used judiciously and should be of limited duration. Here again, the experience of North America and Europe with local development incentives has been disappointing. Many noneconomic ventures have been leveraged with government incentives, and a large proportion have failed, leaving taxpayers to foot the bill.

4. Labor and Migration Policies

Resource mobility is the hallmark of an open economy, including the free movement of labor. But given the enormous population pressures in China, labor mobility must be directed and contained except when there is clear evidence of skill shortages in particular regions.

5. Private Ownership and Property Rights

China has already made substantial progress in privatizing industry. The next step must be to establish a system of property rights under law. Though this is clearly the correct approach for ensuring more rapid economic growth in the future, privatization by itself will neither stimulate lagging regions nor narrow income differentials in the short term. What's more, to the extent SOEs simply become private monopolies or oligopolies, industrial inefficiencies will still abound, supplies of goods and services will be restricted, and consumers will continue to pay high prices.

6. Infrastructure

Improvements to China's public capital, including highways, airports, water systems, and telecommunications, are an absolute prerequisite to sustainable regional development. Indeed, infrastructure is the fabric that will eventually knit together a unified, integrated national economy. However, improvements to transportation and telecommunications networks will also facilitate mobility among regions and make it more difficult to control labor movement.

7. Lowering Trade Barriers among Regions

At present, a host of direct and indirect impediments to the movement of raw materials, goods, and services among China's regions is retarding the process of economic integration. These barriers must be removed without delay.

8. Technology Policy

China has established several dozen industrial technology centers across the country. Careful analyses should be performed to assess how these centers can facilitate technology transfer and regional economic development.

9. Human Capital

Finally, China's policies on education and training will have significant impact on all provinces and municipalities. Perhaps the most important role the central government can play in fostering regional economic development over the long term will be to ensure that high school graduates have mastered the basic requirements for lifetime employment, namely literacy and numeracy. The experience of the West demonstrates strongly that a good system of secondary and vocational education is a more critical element in the regional development process than even higher education.

CHINA'S FUTURE: CAN A SOCIALIST MARKET ECONOMY DELIVER THE GOODS?

A corollary to the infamous economic axiom that "there ain't no free lunch" should probably be "there ain't no economic miracles." Yes, China's growth has been spectacular in recent years, and the rapid pace of development may continue for some time. But the explanations for China's success are really quite simple: education, deregulation, and privatization.

China's economy today is perhaps best described as one of semicontrolled chaos. It is simultaneously entrepreneurial, anarchic, dynamic, and corrupt. Can the boom last? The answer is unknowable, as are most questions about China's future. The Chinese themselves, however, appear increasingly skeptical about their country's economic future, as shown by capital outflows of $10 billion to $15 billion annually in recent years. As a Western economist based in Beijing observed recently, "One wonders why foreigners are so desperate to invest here when the Chinese seem to be so desperate to invest overseas."

The next five years will be critical, what with the presumed passing of Deng Xiaoping, the takeover of Hong Kong, and the inevitable political intrigues that will follow these developments. But regardless of how the leadership struggle sorts itself out, absent the evolution of democratic institutions and a rule of law, the Chinese economy will eventually disintegrate.

[Author note]

BERNARD L. WEINSTEIN, Ph.D., is Director of the Center for Economic Development and Research and Professor of Applied Economics, University of North Texas, Denton.